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C O N F I D E N T I A L SECTION 01 OF 03 ANKARA 000316

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E.O. 12958: DECL: 02/19/2018

TAGS: [ENRG](#) [EPET](#) [TU](#)

SUBJECT: TURKEY NEEDS GAS TO BE A RELIABLE TRANSIT PARTNER

REF: A. ANKARA 00035
 [B.](#) ANKARA 02955
 [C.](#) ATHENS 00187

Classified By: Ambassador Ross Wilson for reasons 1.4 (B) and (D)

[¶](#)1. (C) Summary. Turkey is under increasing pressure to conclude a transit agreement with Azerbaijan to clear the way for Caspian gas to flow into Europe. The negotiation between Turkey and Azerbaijan is not only about transit but also about supply. Our Caspian Strategy needs to look at Turkey as a consumer as well as a transit country. Turkey imports more than 98 percent of its gas supply. It wants to limit those imports to no more than 30 percent from any one country. As the recent gas cutoff to Greece showed, Turkey is now only as reliable a gas transit country as its most unreliable supplier, Iran. In a February 12 meeting with the Ambassador, Energy Minister Guler described Turkey's 15 percent domestic offtake formula as the only way to meet domestic gas demand. Turkey's insecurity about its future gas supply is driving Guler and others to stick to this formulation, although we doubt they fully understand all the risks that formula creates. Turkey is pursuing increased energy security with the development of nuclear, wind, coal, increased domestic gas production and conservation but these will take time. We need to encourage Turkey to pursue supply and transit agreements with Azerbaijan; develop more gas storage and LNG offload facilities to weather short-term gas cutoffs; and educate Turkey about the consequences of being an unreliable transit partner. End summary.

What Can We Learn From Turkey's Gas Cut Off to Greece?

[¶](#)2. (C) The Turkey-Greece gas agreement is unusual. It provides that Turkey acts as a middleman, buying gas from Azerbaijan and selling it to Greece. In essence, Turkey takes ownership of the gas at the Azeri border, assuming some commodity risk (i.e. the risk that gas price may rise or fall before it sells the gas to Greece at a fixed price). This purchase arrangement makes it possible to redirect Azeri gas to the Turkish domestic market when needed.

[¶](#)3. (C) The gas cut off from Iran meant that Turkey was forced to find additional gas supplies on the LNG market and from Russia at substantially higher costs for domestic use. Turkey also had to pay for electricity producers to switch

from gas to higher priced alternative fuels (ref A). During the cutoff, the average gas purchase price increased while the sales price to Greece stayed constant at a level below the prevailing price, resulting in a loss. This situation argues against Turkey concluding any additional contracts to buy and sell gas for transit to third countries. Turkey's ability to make up for lost volumes is not just a price issue. Limited pipeline infrastructure, limited gas storage and only two LNG terminals located in Marmara and Izmir make it difficult for Turkey to continue business as usual when gas supplies are cut.

Why Should We Care About Turkey's Domestic Demand?

¶4. (C) We believe Turkey can only be a reliable supplier as its own domestic demand is met. Put more bluntly, Turkey is only as reliable as its most unreliable gas supplier, Iran, which provides 18 percent of Turkey's gas. U.S. Caspian strategy is premised on Turkey being a reliable transit partner for Caspian oil and gas resources to Europe. Nabucco won't be built without confidence in a reliable supply from Turkey. Turkey, in turn, is reliant on other countries for 98 percent of its domestic gas.

¶5. (C) We believe a prudent U.S. Caspian strategy needs to take into account Turkey's own growing need for gas. Turkey is facing an imminent energy shortage and is highly insecure about its future gas supply. Energy shortages have already caused rolling blackouts. According to Energy Market Regulatory Authority Commissioner Huseyin Karatas, Turkey will be about 2,000 MW short of electricity this summer, which will likely result in more black outs and rising public

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disaffection with the government.

¶6. (C) About 50 percent of Turkey's total gas consumption (36 bcm) is used for electricity. With annual energy growth projections at 8-9 percent, Turkey's demand for gas will double by approximately 2015. According to BP Turkey Director Tahir Uysal, the next volumes to come online from Azeri Shah Deniz Phase II development (notably 12 bcm by 2015) could be consumed in large part by Azerbaijan and Turkey, leaving less to transit to Europe than we estimated. (Note: We understand recent discoveries of deep gas by the commercial consortium operating the Shah Deniz field indicate that gas volumes, in an optimistic scenario, could reach 20 bcm. End note.)

¶7. (C) Turkish energy strategy calls for no single country to supply more than 30 percent of its gas, but it is not clear where alternate supplies will come from (ref B). Russia now supplies 60 percent of Turkish gas. Iranian gas (18 percent of the total) is unreliable, additional Azerbaijani gas will not be available in the short term, Turkmen gas is only as reliable as its supply route through Iran, and Iraqi gas is still hypothetical, pending the passage of the hydrocarbon law and further upstream development. The best option in the short term is expensive LNG from North Africa and Qatar, but Turkey can only import a limited quantity, because it has only two LNG terminals. There are alternative energy sources in the works, particularly nuclear, wind, and more hydro projects. But all of these are uncertain and are unlikely to provide power for years to come.

What Is Wrong With 15 Percent Offtake?

¶8. (C) Despite our calls to separate negotiations on transit from supply, Minister Guler in a meeting with the Ambassador fiercely defended the provisions of the July 2007 Turkey-Greece-Italy Intergovernmental Agreement (IGA), notably the 15 percent offtake formula at net-back prices, as the only hope for Turkey to meet its growing domestic gas

demand. Guler's insistence on the offtake formula reflects Turkey's insecurity about supply and unwillingness to be a transit country without help meeting its domestic supply concerns. But the offtake formula may create more problems than it solves for Turkey. The Ambassador explained to Guler that Turkey is not assured of any specific quantity of gas, nor that the gas will be any less expensive than alternatives under the provisions of the IGA. Turkey's gas supplies from Azerbaijan become dependent on others' decisions. A better model for Turkey is to strike the best deal with Azerbaijan and charge appropriate fees for the transit of gas to markets beyond.

¶9. (C) While the formula is not ideal from the point of view of energy security, Guler fears that without this formula, Turkey will be cut off from Caspian resources. Several times, Guler dismissed our suggestion to conclude a separate supply agreement with Azerbaijan but added he was open to new ideas on how to meet Turkey's supply needs. With Italy and Greece set to buy 11.5 bcm (ref C) and with original estimates of Shah Deniz II output at 12 bcm, Turkey may fear that giving up the transit percentage volumes will leave it with no additional supply from Azerbaijan.

What Can We Do?

¶10. (C) --Encourage Azerbaijan and Turkey to have a candid discussion on what volumes will be available for Turkish purchase along with transit talks. Assuring gas supply is as important as transit.

--Encourage Turkey to make itself more reliable by increasing its gas storage and expanding its LNG offtake facilities to see it through short-term cut offs like the annual winter two-to-four week Iranian gas cut off.

--Educate Turkey about the negative consequences of being an

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unreliable transit partner. Those consequences could include construction of alternative pipeline that bypass Turkey; cancellation of planned projects in Turkey and financial penalties for not meeting contract requirements.

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